

Summary of Global Outlook

The outlook for the global economy remains positive and favorable for U.S. banks. Growth has clearly revived in Europe and is picking up in other parts of the world. Bank earnings from international operations continue to be significant.

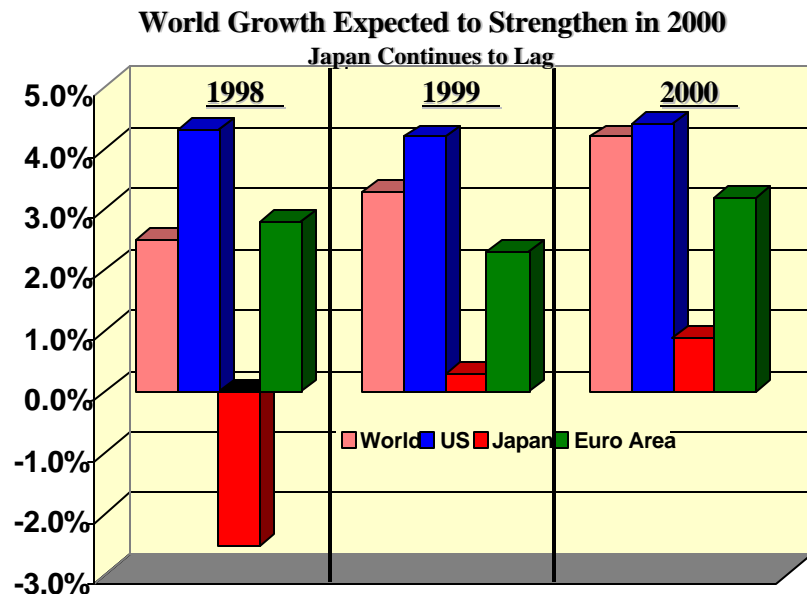
Despite this, the international environment does pose substantial risks. The U.S. current account deficit has now surpassed previous records and is projected to hit \$400 billion, and over 4% of GDP, this year. Financing the deficit will require continued large inflows of foreign investment. Although to date there has been no problem in attracting sufficient funds, the costs to the U.S. of servicing its international debt are building and the situation is not sustainable indefinitely.

Transition to a more sustainable balance may occur without major disruption. This would require a gradual slowing in U.S. domestic demand and an external environment that remains favorable. However, there is a risk that pressures to adjust could arise quickly and trigger a sharp downward move in the dollar. This would likely lead to further substantial upward pressure on U.S. interest rates.

Such a scenario would likely be quite negative for U.S. securities markets, especially for equities. Foreign interest may be disproportionately affected by the prospect of losses from both a decline in principal value and from foreign exchange translation. Foreigners have been significantly increasing their investment in U.S. equities over the last few years and have become one of the most important sectors purchasing domestic stocks. A substantial diminution in their interest could exacerbate a downward correction in U.S. equity markets. There is also the potential for such developments to spillover into foreign stock markets.

Macro-Economic Outlook

The pace of world economic expansion is expected to pick up strongly this year. For the first time since the outbreak of the Asian financial crisis, global growth is likely to exceed the 4 percent level. Activity in the U.S. will continue to be robust and should again outstrip that in other industrial countries and the world as a whole. However, the improved outlook is primarily attributable to the strengthening in other parts of the world. Most importantly the European Union, with an economy roughly comparable to that of the U.S., now appears poised to exceed 3 percent growth for the first time in over a decade. Japan remains an important laggard, but analysts have become more optimistic about prospects there. Emerging Asia looks set for another solid performance, after last year's much stronger than anticipated rebound. Latin America, having weathered substantial economic shocks in 1999, is set to return to positive growth this year; the pick up should be most evident in the second half of 2000.

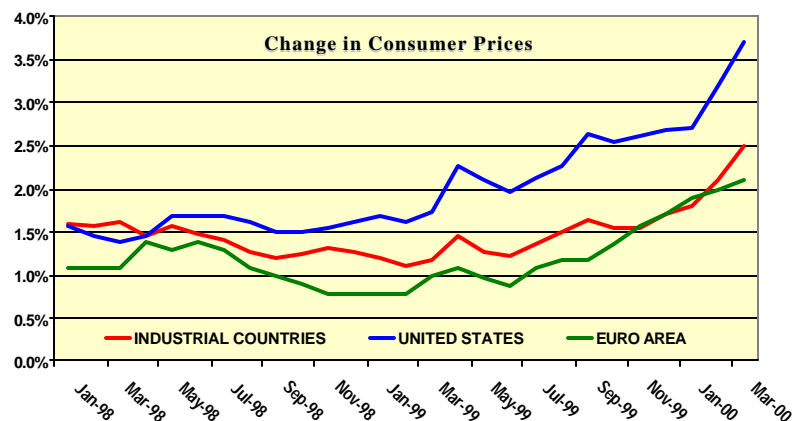


Source: IMF, World Economic Outlook, April 2000

Price Levels Rise

Stronger world growth and persistent robust U.S. demand are being reflected in rising price levels. The direct impact of the increase in petroleum prices is an important factor, but core inflation is also rising in the U.S. and Europe. The consensus among private sector analysts continues to point to moderate and contained increases in prices. However, the risk of a sharper upward move has increased. With its economy still lagging behind the rest of the industrialized world, Japan is an exception to the price trend.

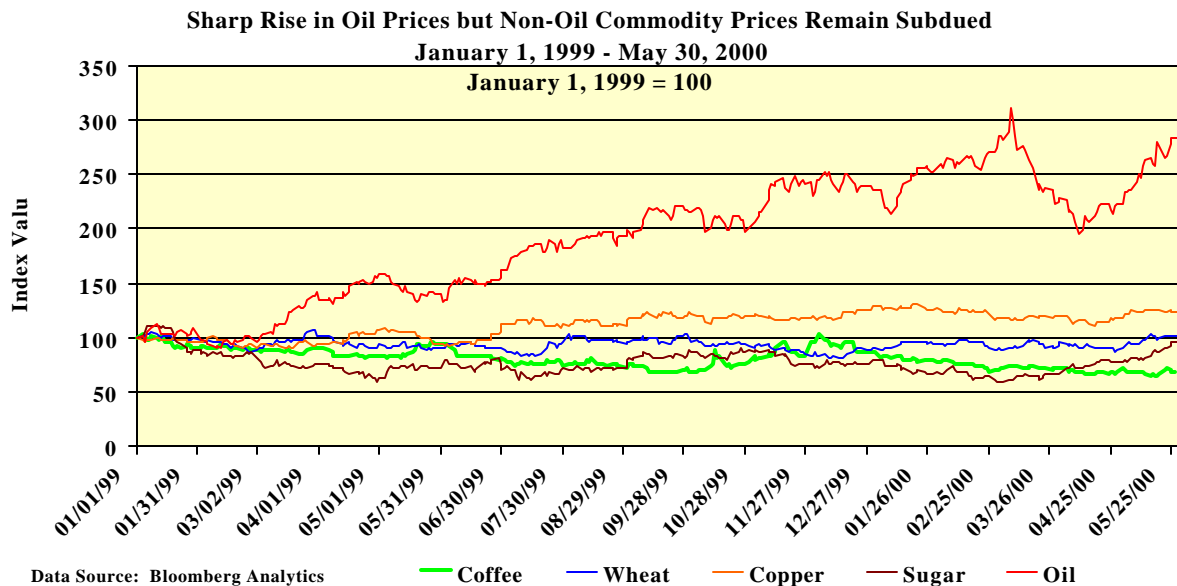
Pace of Increase in Prices Picks Up In Most Industrial Countries
(From Low Levels)



Source: IMF

Commodity Prices

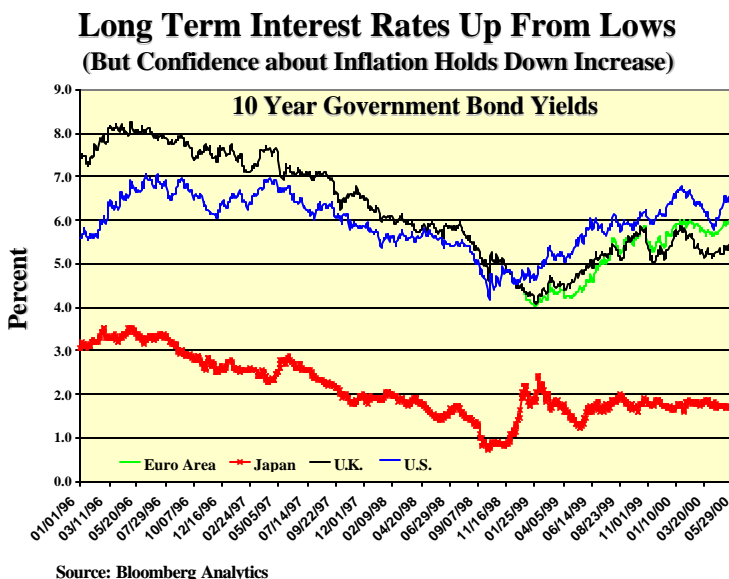
The price of petroleum, which hit US \$30 per barrel for the first time in a decade earlier this year, eased in the second quarter. Most analysts believe the peak has passed and



anticipate that prices will stay in the US\$22-US\$28/barrel range agreed upon by OPEC. Prices for other commodities have remained largely stagnant over the past year but, with world economic growth accelerating, are widely expected to firm. This should provide some benefit to a broader range of commodity exporting countries, although, their gains will not match those that have accrued to oil producers. For many emerging market economies, just as for industrialized countries, higher commodity prices will keep upward pressure on inflation and interest rates. Some producing countries are attempting to control production and thereby further lift prices. For example, there are indications that the new Chilean government is attempting to scale back copper production. This tactic is most likely to be appealing when there are a limited number of producers.

Interest Rates

Concern about inflationary pressure has led to higher interest rates in Europe and the U.S. The upward move, which began in late 1998 and early 1999, when a number of countries were experiencing the lowest rates in decades, has continued. So far, the



increase has been more pronounced for short term rates, which has led to a flattening (and in some cases an inversion) of the yield curve. In part, the more limited rise in longer term rates reflects continued market confidence in the ability of monetary authorities to contain inflationary pressures.

Another important factor has been a change in the supply of government bonds. This is most noticeable in the U.S., where a substantial fiscal surplus has reduced funding requirements and allowed

shrinkage in the stock of bonds outstanding. In Continental Europe there has also been a drop in governments' needs for funds, as countries continue to benefit from the impact of fiscal reform undertaken to meet the criteria for a single currency. In recent years, this has been reinforced by strong growth in tax receipts flowing from buoyant security markets.

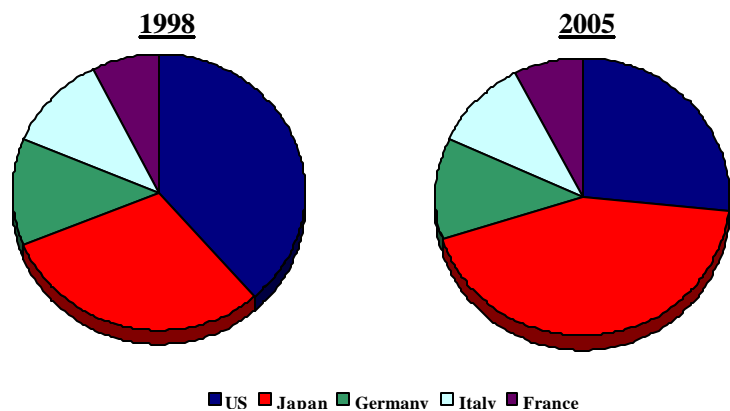
Japan, however, remains subject to a different set of forces. With the private sector sluggish and price levels still on the decline, Japanese authorities continue to prescribe large doses of

government spending for the country's economic ills. As a result, fiscal accounts have moved very deeply into the red financed by massive issuance of government bonds.

These very different directions in fiscal policy will lead to significant alternations in the structure of global sovereign debt markets.

Japanese Issues to Dominate Sovereign Bond Market

Stock of Outstanding Sovereign G-5 Bonds

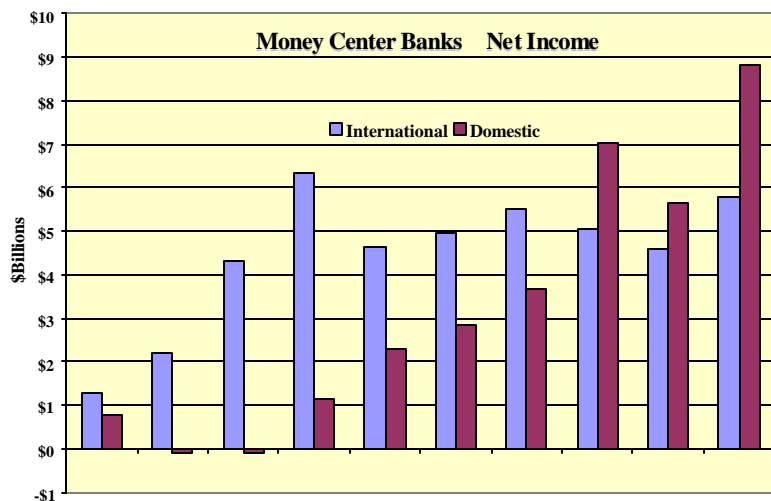


Source: Organization of Economic Cooperation and Development

Overall Environment Remains Positive for Banks

Despite the upward trend in interest rates, the operating environment for banks has been very favorable. Strong economic growth is producing rising incomes and healthy corporate profits. With business activity picking up, there has been an active global merger and acquisition business, which banks have helped finance. In addition, the significant appreciation in asset markets

Domestic Income Surges - International Income Remains Important



Banks include: BofA/Nations, Bank One/First Chicago, Citibank, Chase/Chemical, Morgan, Bankers Trust

Source: NBSVDS/Call Report Data

around the world has produced substantial increases in real wealth, thereby enhancing borrowers' ability to repay. These positive factors are reflected in buoyant income for U.S. banks from both domestic and international sources. As a result, last year U.S. banks' international income fully rebounded from the dip experienced as the result of the Asian and Russian financial crises.

Despite the positive environment, important risks remain on the international front. One of the most significant risks stems from the U.S. current account deficit.

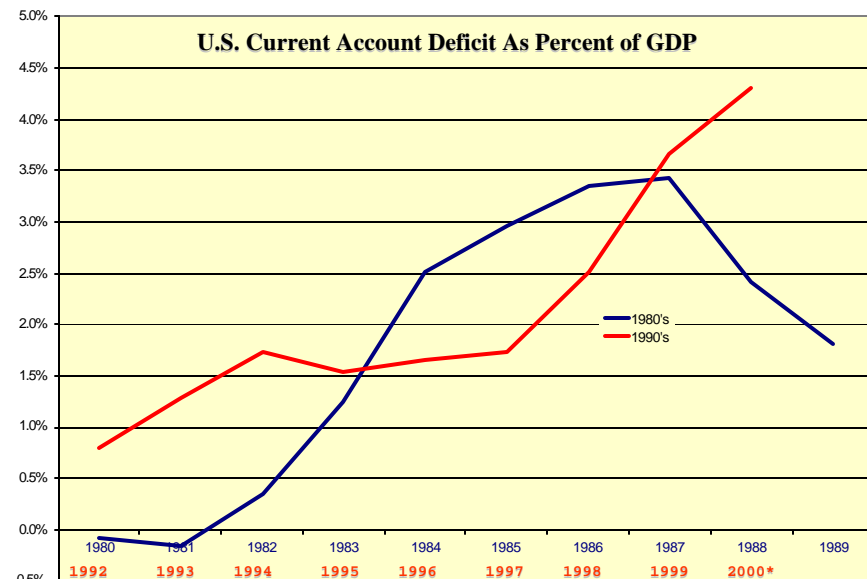
Current Account Imbalance

Surging domestic demand, which has been the principal force behind U.S. growth, continues to outstrip expansion of total domestic production. As a result, U.S. consumers and businesses have increasingly come to rely on foreign countries to supply an important part of

their goods and services. Last year, the U.S. recorded the largest current account deficit in its history, surpassing its previous high hit in the mid 1980s. Projections are for continued expansion of the red ink, which some analysts anticipate will approach 5% of GDP by the end of the year, despite growing overseas demand for U.S.

exports from strengthening foreign economies. Analysts believe that as long as U.S. domestic demand continues to expand strongly, additional sales of U.S. goods abroad will not be sufficient to significantly reduce the current account deficit.

Current Account Deficit Exceeds 1980s Levels



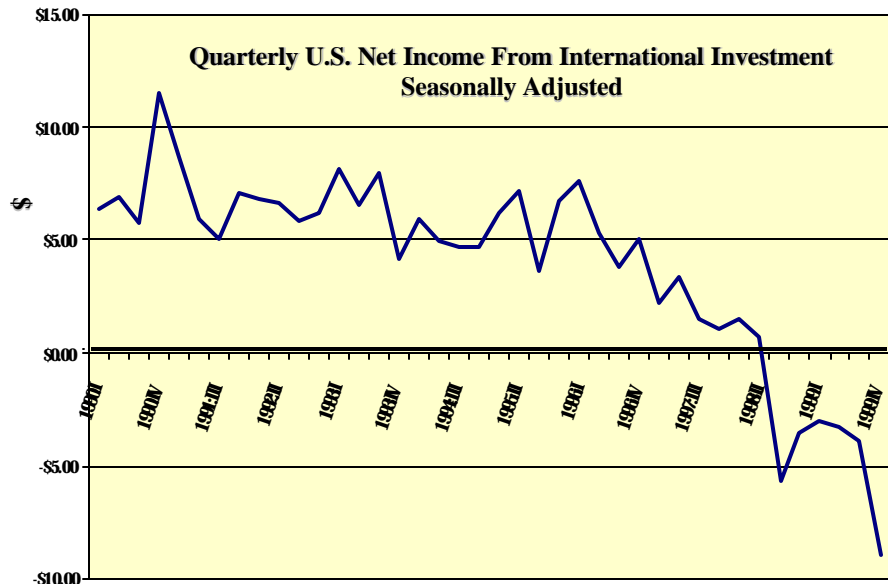
* IMF April 2000 World Economic Outlook Projection

International Investment Income

The current account deficit is primarily financed by inflows of foreign investment. As the U.S. external deficits have grown, so have foreign holdings here and the earnings accruing to foreigners.

From 1914 through 1997 earnings on U.S. assets abroad more than covered payments to foreigners on their American investments. However in the last half of 1998, as the stock of foreign investment in the U.S. continued to swell, foreigners' income on investments exceeded returns to U.S. residents on their holdings abroad for the first time in almost 85 years. Net payments to foreigners grew further last year reflecting additional increases in their holdings in the U.S. Financing of this year's current account deficit will further expand the stock of foreign debt and will generate growing net income payments to foreigners. In the absence of other changes, the additional payments will further extend our current account deficit. This will require a corresponding increase in the size of inflows of foreign investment and subsequently further boost net investment income payments to foreigners. There is general agreement among analysts that this process cannot continue indefinitely; at some point the U.S. must curtail the size of its current account deficit.

Shift in International Investment Income Complicates Adjustment



Source: U.S. Bureau of Economic Analysis

Soft Landing Scenario

It is possible that economic adjustments in the U.S. could result in a lowering of the current account deficit without significant disruption to financial markets or the overall macro-economic environment. In part, this outcome would be dependent on favorable external developments. A slowing in the growth of U.S. domestic demand, as the result of higher interest rates or a decline in stock market valuations for example, would curb the acceleration in import purchases and allow for expansion of exports. An improved international environment would enhance demand for U.S. exports and buffer the impact of the deceleration in internal demand. (Europe would need to have a period of sustained strong growth, the Japanese economy would need to rebound and the emerging world would have to avoid a major crisis.) Under this scenario, the adjustments would occur

gradually and the resulting U.S. economy would be expanding at a slower but sustainable pace. The U.S. output mix would be more oriented towards exports and replacements for imports, as higher import prices induced some shifting of consumption towards domestic goods and services.

Comparison of Current Environment With that of Mid 1980s

A soft landing also presumes the continued availability of foreign financing at close to current conditions during the adjustment process. If there is a significant decrease in foreigners' willingness to provide funding, sharp movements in financial markets are likely, with potentially

important

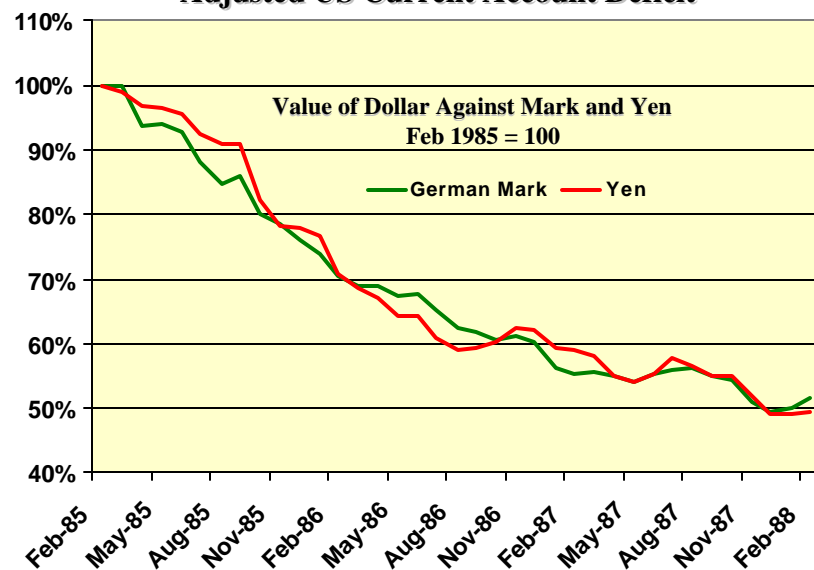
macroeconomic

consequences. In the mid 1980s, the last time that we had very large imbalances in our external accounts, trade flows shifted after a sizable realignment of exchange rates. This occurred when it became clear that the large U.S. trade account deficit would not continue to be tolerated and the dollar began a significant depreciation. The currency moved down

by 40 percent against both the German mark and the Japanese yen within 18 months of its peak and shed another 10 percent the following year. The decline was relatively steady and gradual, and the adjustment did not prove especially disruptive for overall U.S. economic growth.

Sizable Dollar Correction in Mid 1980s

Adjusted US Current Account Deficit

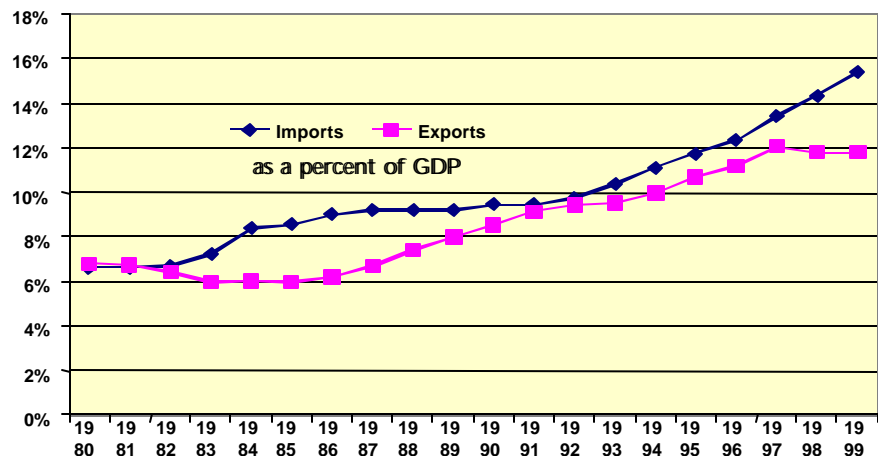


It is unlikely that we would experience a replay of such a large, and relatively benign adjustment in relative prices. The impact on the U.S. economy and on world financial markets of a comparable exchange rate adjustment is likely to be more significant and disruptive now. The current account deficit now is larger relative to U.S. GDP and trade is more significant to the domestic economy. Most importantly in the 1980s there was a combination of slack in the U.S. economy, declining domestic interest rates and our securities markets were trending up. In contrast, U.S. monetary officials are now worried about overheating. Interest rates are rising. Securities markets are off their highs, and investors are apprehensive about the possibility of a sharper correction.

Trade's growing share of the U.S. economy will magnify the impact of a movement of exchange rates. Since 1985 exports and imports have almost doubled as a percentage of GDP. In part, this reflects significant reductions in trade barriers and a more market oriented approach to policy making in foreign countries. This has produced important

benefits for the U.S. and the rest of the world. However, it also increases the effect of any exchange rate adjustments. A sizable decline in the U.S. dollar's value would first be felt in upward pressure on prices. The dollar value of imports and exports would rise to reflect the now more expensive foreign currency prices. For example, a 12% depreciation in the dollar translated into corresponding increases in the dollar price of exports and imports would lift aggregate U.S. prices by approximately 3%. [In practice the impact would be altered by, among other things, adjustments in the volume of exports and imports.] A rise of this magnitude in the price index would probably produce secondary effects as workers and property owners try to catch up via higher wages, rent and profits.

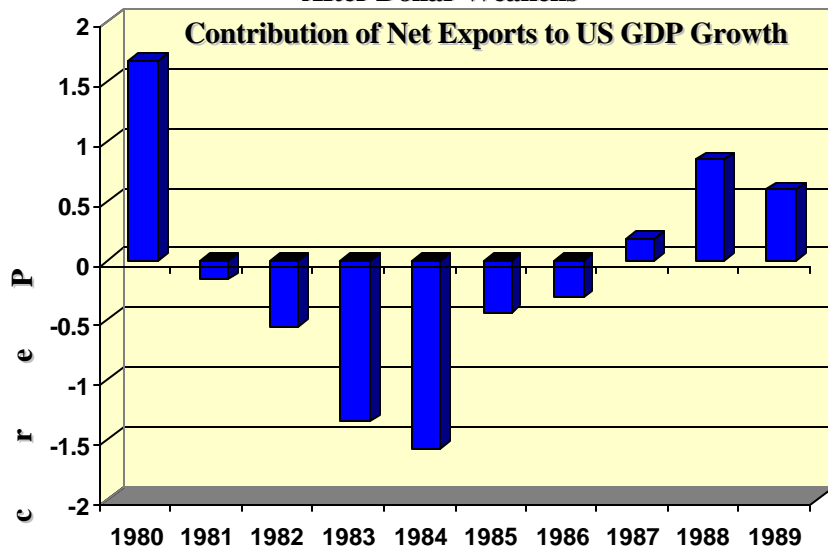
Foreign Trade More Important in the U.S. Economy



In the 1980s, large swings in the external sector induced by the depreciation of the dollar had important positive implications for the overall economy. In 1984 the U.S. was a large net importer.

The imbalance between exports and imports subtracted almost 1.5% from U.S. GDP. Following the exchange rate adjustment (and after a lag), export sales rose sharply in reaction to the relatively lower prices for U.S. goods. In addition, American consumers shifted away from higher priced imports towards domestic products.

Export Sector Shifts From Drag to Boost to Economy After Dollar Weakens



Between 1984 and 1988, the swing in net exports totaled 2% of GDP. To meet this additional demand for its products, the U.S. had to be able to increase its production of goods and services (or correspondingly reduce its domestic consumption). In the mid 1980s, the economy could accommodate the extra demand stemming from the exchange rate movement. The U.S. was only a few years removed from the steep recession of the early 1980s. Unemployment remained over 7 percent and adequate capacity existed to enlarge overall production without major strain.

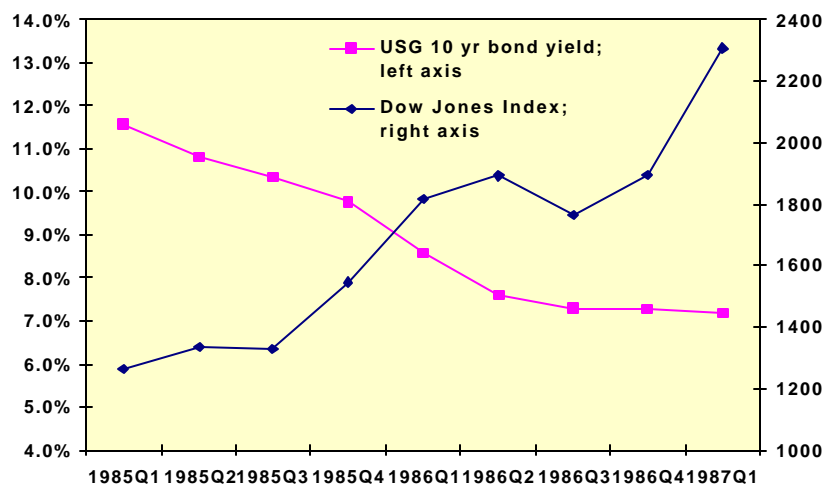
In contrast, in 2000 the U.S. is enjoying the longest economic expansion on record, and the unemployment rate is at its lowest level in decades. Concern about the economy's capacity to meet existing demand is leading to higher interest rates. Any significant additional stimulus from the external side is likely to add to the pressures on labor supply and on interest rates. For example, the Federal Reserve model of the economy indicates that an increase of about 100 basis points in interest rates would be necessary to offset the income effect of a 12% dollar depreciation. This increase would be on top of any other upward moves in rates based on the current high level of domestic demand.

This likely upward move of interest rates in reaction to a weaker dollar is in sharp contrast to events in the mid 1980s. Then interest rates dropped despite the currency's weakness. That led to gains in securities markets, which largely offset translation losses from dollar

holdings. This may explain, in part, why the depreciation of the dollar was fairly smooth in financial markets. At that point, inflation, which had hit double digits in the late 1970s, was in retreat and U.S. interest rates were still adjusting to the changed environment. As

borrowers (lenders) were steadily lowering their expectations of future price rises, they were willing to pay (demanding to receive) less of an inflation premium for long term funds. In addition, monetary policy, which had been tightened in the beginning of the decade to check inflation, was accommodative. The dollar's depreciation did not re-ignite concern about inflation because trade was a relatively small percentage of the U.S. economy. As a result, the decline in interest rates continued even as the dollar weakened through early 1987.

**In Mid 1980s U.S. Securities Markets Strengthened
Offsetting Much of Dollar's Decline**

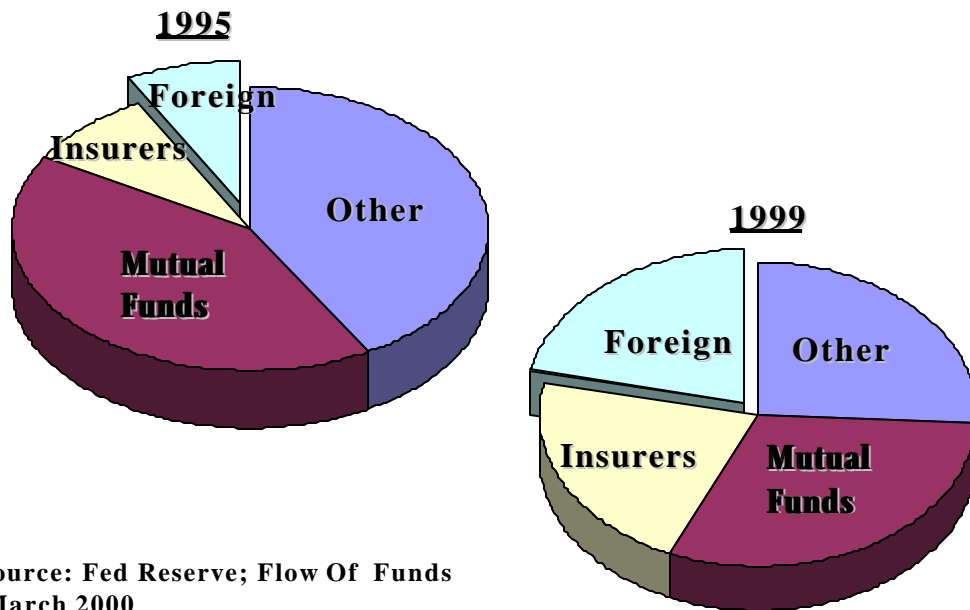


Hard Landing Scenario

If foreigners decide not to further expand holdings of dollar denominated assets, for example out of concerns about the sustainability of the U.S. current account deficit or as a result of deteriorating prospects for returns on U.S. assets, this could produce significant movement in financial markets and have important macro-economic implications. As illustrated above, as the dollar weakened, the inflationary implications of higher priced tradable goods and the pressure of extra demand for U.S. products would likely lead to additional interest rate hikes, beyond those already being driven by current domestic considerations. The U.S. securities market would be likely to drop in response, which could further discourage the holding of dollars. In this environment, a significant downward move in financial markets is possible.

Foreign Purchases Increasingly Important to U.S. Equities Markets

(Share of Net Purchases of U. S. Equities)



Source: Fed Reserve; Flow Of Funds
March 2000

The equities market may be especially impacted by a change in overseas sentiment towards the dollar, since foreign purchases have become increasingly important to U.S. stocks. In effect, the U.S. has been financing a growing share of its current account deficit by sales of equities to foreigners. Some of this is connected to mergers and acquisitions but high rates of return have attracted many foreign investors in U.S. equity markets. A drying up of foreign interest will likely have a notable depressing effect on U.S. equity prices.

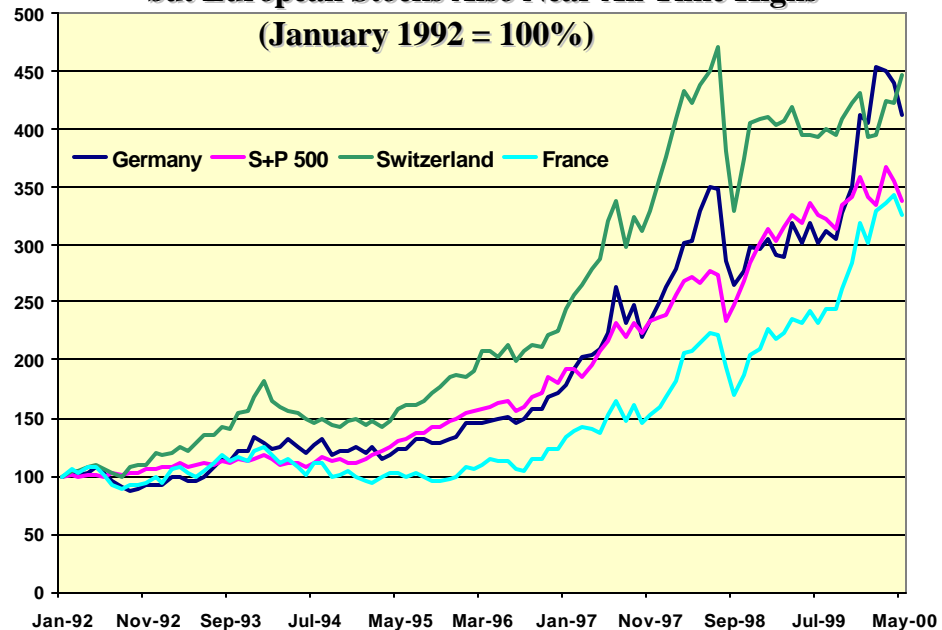
There is also a potential for significant spillover impacts on other stock markets if the prices of U.S.

equities tumble.

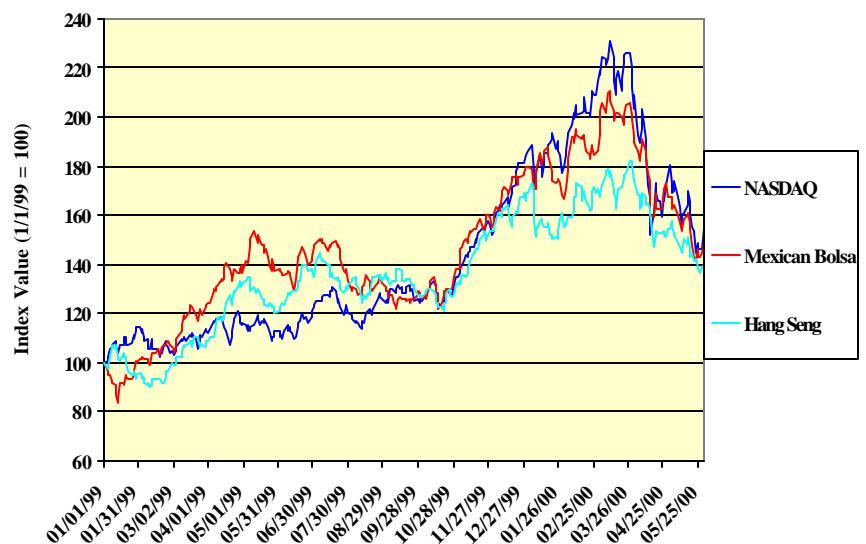
European markets are also near or at all time highs, although based on historic price earnings relationships they tend not to be as extended as U.S. equities. A sizable correction in the U.S. could spark sales in Europe.

Equities in emerging markets may be even more vulnerable. In a number of important cases, they have been tracking developments in the Nasdaq. In some cases, this reflects the growing importance of high tech companies in local equity markets. A sharp slowdown in global equities could negatively affect confidence and investment.

U.S. Equity Markets Considered Vulnerable but European Stocks Also Near All Time Highs (January 1992 = 100%)



Major Emerging Market Stocks Moving With NASDAQ



Data Source: Bloomberg Analytics